

(3)
No. 89-2027

Supreme Court, U.S.
FILED
AUG 22 1989
JOSEPH F. SPANIO, JR.
CLERK

In The
Supreme Court of the United States
October Term, 1989

SOUTH CAROLINA STATE EDUCATION
ASSISTANCE AUTHORITY,

Petitioner,

vs.

LAURO F. CAVAZOS, in his official
capacity as Secretary, United States
Department of Education, and UNITED
STATES DEPARTMENT OF EDUCATION,

Respondents.

Petition For Writ Of Certiorari To The
United States Court Of Appeals
For The Fourth Circuit

REPLY BRIEF

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REPLY BRIEF

Petitioner South Carolina State Education Assistance
Authority (S.C. Authority) respectfully replies to the Brief
for the Respondent Secretary Cavazos and other Respon-
dents (Secretary) in Opposition as follows:

ARGUMENT I

THE COURT OF APPEALS DECISION CONFLICTS WITH THE DECISIONS OF THE UNITED STATES SUPREME COURT.

A. THE DECISION OF THE COURT OF APPEALS CONFLICTS WITH A NUMBER OF DECISIONS OF THIS COURT WHICH RECOGNIZE THAT THE CONTRACTS OF THE UNITED STATES ARE BINDING.

The Secretary and the Court of Appeals for the Fourth Circuit have misapplied *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41, 91 L.Ed.2d 35, 106 S.Ct. 2390 (1986). Although *Bowen* (referred as *POSSE* by the Secretary) stated that Congress' power to legislate with respect to contracts and other matters remained intact unless surrendered in unmistakable terms, such a surrender has occurred here in that Congress granted the S.C. Authority and other guaranty agencies a contractual right to reimbursement for the life of the student loans guaranteed by these agencies. 20 U.S.C. Section 1078(c)(1)(A).

Moreover, even if Congress had not, as it has done here, expressly surrendered its power to legislate as to loans guaranteed by the S.C. Authority prior to the December, 1987 amendments to 20 U.S.C. Section 1072 (P.L. 100-203, 100 STAT. 1330-36 § 3001) (December, 1987 amendments)), *Bowen* makes clear that Congress could not by its legislative power deprive the S.C. Authority of its property interest in receiving reimbursements for loans guaranteed prior to the December, 1987 amendments. *Bowen* clearly states that " . . . Congress [cannot rely upon a reserved power to amend] to take away property already acquired under the operation of a charter, or deprive the corporation of fruits already reduced

to the possession of contracts already made." 477 U.S. at 55, 106 S.Ct. at 2398. These limits on Congress' power to amend were emphasized in *The Sinking Fund Cases*, 99 U.S. (9 Otto) 700, 25 L.Ed. 496 (1879). The *Sinking Fund Cases* plainly held that "Congress cannot undo what has already been done, and it cannot unmake contracts that have already been made. . . ."

Although cited by the Secretary in support of his argument, *Miller v. State*, 82 U.S. (15 Wall.) 478, 495-497, 21 L.Ed. 98 (1873) and *Looker v. Maynard*, 179 U.S. 46, 52, 45 L.Ed. 79, 21 S.Ct. 22 (1900) support the S.C. Authority's position. In particular, *Miller* clearly stated that the " . . . power to legislate [upon a reserved power to amend] is certainly not without limit and it may well be admitted that it cannot be exercised to take away or destroy rights acquired by virtue of . . . a charter. . . ." 15 Wall. at 498, 21 L.Ed. 104. See also, *Looker and Pennsylvania College Cases*, 80 U.S. (13 Wall.) 190, 20 L.Ed. 550 (1871). *Stockholders v. Sterling*, 300 U.S. 175, 183, 81 L.Ed. 586, 57 S.Ct. 386 (1937), cited by the Secretary, is inapplicable here to the reimbursements for preexisting loans because the court clearly stated that it was not reaching the issue in that case of whether changes in legislation would effect preexisting debts.

The Secretary fails to avoid the application of this authority to the instant case. Although one of the two agreements between the Secretary and the S.C. Authority states that the S.C. Authority "shall be bound by all changes in the Act or regulations in accordance with their effective dates," he overlooks that other provisions of the agreements refer to the "obligation" to make reimbursement payments and state that termination of the Agreement "shall not effect obligations incurred under this

Agreement by either party before the effective date of termination. . . . " (Agreements in Record below). These provisions make clear that the agreements cannot be changed by Congress or the Secretary as to loans guaranteed prior to the changes.

The Secretary also surprisingly argues against the plain meaning of 20 U.S.C. Section 1078(c)(1)(A) which provides that State guaranty agencies " . . . shall be deemed to have a contractual right against the United States, during the life of such loan, to receive reimbursement. . . . " He attempts to sidestep the meaning of this statute by stating that "no one acquires a property right in legislation" (Brief of Respondents at 19), but the property interest here is in the contractual right to reimbursements, not in legislation itself.

The Secretary's arguments concerning these provisions in the contract and the legislation all fail under the above Supreme Court Authority and under *Lynch v. United States*, 292 U.S. 571, 78 L.Ed. 1434, 54 S.Ct. 840 (1934), a case directly on point here. The contracts and legislation applicable to the war risk policies in *Lynch* contained language referencing changes in the law similar to that quoted above from the S.C. Authority's agreement, but the Supreme Court held that such language was insufficient to permit an amendment abrogating vested rights. The Court noted that " . . . no power to curtail the amount of the benefits which Congress contracted to pay was reserved to Congress; and none could be given by any regulation promulgated by the Administrator.", 292 U.S. at 577, 54 S.Ct. at 843. *Lynch* found that "Congress was without power to reduce the expenditures by abrogating contractual obligations of the United

States," which is what Congress has done as to reimbursements on preexisting loans in the instant matter. 292 U.S. at 580, 54 S.Ct. at 844.

The Secretary erroneously attempts to distinguish the war risk policies in *Lynch* from the reimbursement agreements at issue because he claims that the reimbursement agreements were executed in connection with a "social welfare program". No case creates a "social welfare" exception to contractual rights. *Lynch* recognized distinctions between contractual rights and legislative gratuities as follows:

"War risk insurance policies are contracts of the United States. . . . True, these contract, unlike others, were not entered into by the United States for a business purpose. . . . the United States [is] bearing both the whole expense of administration and the . . . cost resulting from the hazard of war. *In order to effect a benevolent purpose, heavy burdens were assumed by the government. But the policies, although not entered into for gain, are legal obligations of the same dignity as other contracts of the United States and possess the same legal incident.* War risk insurance, while resembling in benevolent purpose pensions, compensation allowances . . . and other privileges accorded to former members of the Army or Navy or their dependents differ from the fundamentally in legal incidents. Pensions, compensation allowances and privileges are gratuities. They involve no agreement of parties; and the grant of them creates no vested right. . . . On the other hand, war risk policies, being contracts, are property and create vested rights. The terms of these contracts are to be found in part in the policy, in part in the statutes under which they are issued and the regulations promulgated thereunder." 292 U.S. at 576, 54 S.Ct. at 842. (*emphasis added*).

These conclusions of the court in *Lynch* make clear that merely because a contract is entered for "social welfare" purposes does not undercut the fact that it is a legally enforceable contract which is what the S.C. Authority has in its reimbursement agreements with the Secretary. Had the Secretary and Congress not wanted to extend contractual rights to the S.C. Authority, they could have refrained from signing a binding agreement and refrained from stating in legislation that the S.C. Authority had a contract right. Instead, they did enter contractual relations with the S.C. Authority and they are bound now as to loans guaranteed prior to the December, 1987 amendments.

Finally, the Secretary attempts to sidestep Congress' taking of the S.C. Authority's property interest in the contracts for reimbursement by alleging that the December, 1987 amendments were a means of recapturing excessive reserve funds and for withholding reimbursements from agencies who had not satisfied transfer requirements. Judge Henderson, in her District Court Opinion, properly rejected his arguments as follows:

" . . . The defendants contend that the Federal government regularly withholds funding for certain programs in order to assure compliance with certain policies and that the withholding of reinsurance payments here is no different. Here, however, the requirement that the Secretary is attempting to enforce is itself not binding on the Authority. 'The United States are as much bound by their contracts as are individuals.' [Citing the *Sinking Fund Cases*, 99 U.S. at 719]. Thus, just as the Authority could not unilaterally require the Secretary to pay an additional consideration to continue its role in the [Guaranteed Student Loan Program], the Secretary cannot unilaterally require the Authority to

pay a ransom in order to continue receiving both reimbursements for monies already paid out and administrative cost allowances and advances in accordance with the contract . . . " (App. to Petition, pp. 37(a) and 38(a)).

B. THE S.C. AUTHORITY DOES HAVE AN ENFORCEABLE PROPERTY INTEREST IN ITS RESERVE FUND WHICH HAS BEEN TAKEN BY THE SECRETARY HERE.

The Secretary notes various sources of Maryland's Reserve Fund and alleges that the Federal Government is a "source or catalyst" for most of the Reserve Fund money, but his argument ignores that a number of the sources of the fund are under no control by Federal officials including State Appropriations, investments and "gift(s), grant(s) or other sources," and that the S.C. Authority has broad discretion as to the amount of the insurance premium that it charges as a source for the Reserve Fund. 34 C.F.R. §§ 682.401(6) and 682.410. Although he refers to federal restrictions on the use of the Reserve Fund, the permitted use of the fund include the various purposes for which the S.C. Authority was created under South Carolina law. South Carolina law references only state purposes in its express provisions that the S.C. Authority's loan fund is to be used only for the purposes authorized by State legislation. Sections 59-115-50(c), 59-115-60 and 59-115-110 of the Code of Laws of South Carolina (1976); 34 C.F.R. Sections 682.410(a)(2)(i) and (3); App. to Pet., Ex. H, 47(a). Moreover, an entity clearly can hold a property interest in particular matters even though restrictions exist on the use of that property. See, *Commissioner of Internal Revenue v. Lincoln Savings and Loan*, 403 U.S. 345, 355, 29 L.Ed.2d

519, 91 S.Ct. 1893, 1899 (1971); *Agins v. City of Tiburon*, 447 U.S. 255, 65 L.Ed.2d 106, 100 S.Ct. 2138 (1980); *Euclid v. Ambler Co.*, 272 U.S. 365, 71 L.Ed. 303, 47 S.Ct. 114 (1926); *Buchanan v. Warley*, 245 U.S. 60, 62 L.Ed. 149, 38 S.Ct. 16 (1917).

The Secretary asserts "federalism" here, but he cannot point to a single statutory, regulatory or contractual provision that relinquishes the S.C. Authority's ownership over the Reserve Fund or that grants the Secretary a property interest in that money. Although he asserts that various state laws, including South Carolina's, refer to the Reserve Fund as being held by the Petitioners as trustees, the S.C. Authority's law expressly provides that the funds are to be held in trust for South Carolina's program rather than for the purposes of the federal government. Section 59-115-110 of the Code. (App. to Pet. 54(a)).

Finally, *Dayton-Goose Creek Railway Company v. United States*, 263 U.S. 456, 68 L.Ed. 388, 44 S.Ct. 169 (1924), a case cited by the Secretary, supports the S.C. Authority's property interest in its Reserve Fund. The Goose Creek Railroad was a trustee for the benefit of the United States, the party that was seeking the money, whereas here, the S.C. Authority's money is held in trust for the operation of South Carolina's Guaranteed Student Loan Program in accordance with South Carolina Law. § 59-115-110, *supra*.

ARGUMENT II

THE QUESTIONS PRESENTED BY THIS CASE ARE OF CONTINUING IMPORTANCE.

As shown above and in the Petition, the decision of the Court of Appeals conflicts with the number of decisions of this Court. Although the December, 1987 amendments to Section 1072 have expired, the issues that have been raised in this action will remain, and the S.C. Authority has approximately 2.7 million dollars at stake. Because the issues raised in the instant Petition are likely to arise frequently as to other contractual matters involving the federal government, the Court of Appeals' decision needs to be reversed to avoid future wrongful repudiation by the federal government of the contract and other property interest of entities dealing with the United States.

When important federal questions exist, as here, this Court has agreed to hear cases in the absence of a split in the circuits. In particular, in *Lynch, supra*, this Court granted certiorari and ruled with the *Lynch* plaintiffs even though the defendant United States had prevailed in two circuits before. Here, many related cases concerning the December, 1987 amendments remain pending and the Seventh Circuit has an appeal pending before it. Brief for Respondents, p. 13, n. 11. Most importantly the Fourth Circuit has made a decision in this case that conflicts with the opinions of the Supreme Court.

The decision of the Honorable Karen L. Henderson in the United States District Court for the District of South Carolina rejected the erroneous arguments that were accepted subsequently by the Court of Appeals for the Fourth Circuit, and the Honorable Fredric N. Smalkin agreed with her decision. *Maryland Higher Education Loan*

Corp. v. U.S. Department of Education (D.C.M.D., No. 89-270, June 12, 1989); *rev.* 897 F.2d 1272 (4th Cir., 1990). The S.C. Authority respectfully submits that Judge Henderson's decision should be upheld here and the decision of the Fourth Circuit reversed.

CONCLUSION

The South Carolina Education State Assistance Authority respectfully submits that its Petition for a Writ of Certiorari should be granted.

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August 22, 1990.

